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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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7  
8 IN THE MATTER OF THE APPLICATION OF  
9 RIO RICO UTILITIES, INC., AN ARIZONA  
10 CORPORATION, FOR A DETERMINATION  
11 OF THE FAIR VALUE OF ITS UTILITY  
12 PLANTS AND PROPERTY AND FOR  
13 INCREASES IN ITS WATER AND  
14 WASTEWATER RATES AND CHARGES  
15 FOR UTILITY SERVICE BASED THEREON.

Docket No. WS-02676A-09-0257

12  
13 **RESIDENTIAL UTILITY CONSUMER OFFICE'S ("RUCO")**  
14 **REPLY BRIEF**

15 The Residential Utility Consumer Office ("RUCO") hereby submits its Reply Brief on the  
16 matters raised in Rio Rico Utilities, Inc. ("RRUI," "Rio Rico" or "Company") and Staff's Opening  
17 Briefs.

18 **I. RATE BASE ADJUSTMENTS**

19 **Accumulated Deferred Income Taxes ("ADIT")**

20 The Company is correct that the dispute with RUCO on ADITs is less about the  
21 meaning of ADITs and more about the methodology to calculate it. Company Brief at 9-10.  
22 Contrary to the Company's belief, RUCO's purpose was not to "resurrect" a methodology  
23 whose sole purpose was to reduce the Company's rate base by more than \$1 million.  
24 Company Brief at 11.

1 For the following reasons set forth more fully in RUCO's Closing Brief, the Company's  
2 ADIT recommendation does not make sense. RUCO Brief 2 – 6. The Company's  
3 recommendation does not reconcile with any of the numbers filed on its test year annual report  
4 or its parent's books – both of which show a liability. Id. Nor does the recommendation jibe  
5 with the Company's Schedule E balance sheet which did not show an ADIT balance. RUCO-9  
6 at 14, RUCO-2. The Company's ADIT recommendation changed substantially over the life of  
7 the case, which also makes it suspect, and in the end, the Company is asking the Commission  
8 to approve a large asset. An asset, of course, is an addition to rate base on an expense that  
9 Staff admits is normally a liability. An ADIT asset, according to Staff raises a "red flag". S-6 at  
10 14.

11 What makes an ADIT asset even more "confuzzling" is the fact that the recent  
12 purchases of plant totaling over \$4 million would suggest that ADIT, which measures timing  
13 differences in the amount of taxes collected in rates and the amount of taxes paid, should net  
14 out to a liability. But it doesn't, at least from Staff's standpoint, because of what appears to be  
15 the Company's AIAC balance.

16 There is nothing unusual about AIAC or the Company's AIAC balance, another red flag  
17 associated with the Company's ADIT asset recommendation. Transcript at 897. Yet, another  
18 red flag, as explained in detail in RUCO's Closing Brief, concerns the evidence in this record  
19 on the Company's AIAC refunds. The evidence in this record indicates that based on the AIAC  
20 refunds to date, it is highly unlikely that the Company will refund the full amount of its  
21 advances. RUCO-15, A-8, Bouroussa Rejoinder Schedule B-2 at 6. However, the ADIT asset  
22 is based on 100 percent of the advances being refunded by the Company. Interestingly,  
23 neither the Company nor Staff has addressed this argument in their Briefs or at the hearing.  
24

1 With so many "red" flags it is a wonder that Staff and the Company do not raise the white flag  
2 on this argument.

3 The Company believes that RUCO's use of an allocation methodology to determine  
4 ADIT expense is "irrational" since the Commission denied the approach before and there is  
5 "utility-specific" information available in this case. Company Brief at 13. The Company simply  
6 dismisses RUCO's reliance on the generally accepted accounting standard - FASB 109.

7 Again, RUCO is "confuzzled" with the Company's argument. Like the expenses  
8 associated with the Central Office, ADIT is a balance sheet item. However, according to the  
9 Company, the Commission cannot allocate ADIT, because there is utility specific information  
10 available. Id. Apparently, when it comes to Central Office expenses, either there is no utility  
11 specific information available or there is, but it makes a difference for some reason. The  
12 Company further suggests that the reasoning and the principles associated with the Financial  
13 Accounting Standard Board ("FASB") No. 109 should be dismissed because the Commission  
14 rejected RUCO's position in a prior case involving another utility with different circumstances.  
15 Yet, despite all the red flags associated with the Company's position, the Company would have  
16 the Commission believe that it is RUCO who is advocating the "irrational" position. Rationality  
17 is all perspective – and the Commission should reject the Company's perceived "rational" ADIT  
18 recommendation.

## 19 20 **II. OPERATING INCOME ADJUSTMENTS**

### 21 **Central Office Cost Allocations**

22 The Company continues to miss the point. The Company's misguided approach is  
23 readily apparent from its remarks in its Closing Briefs. The Company acknowledges Staff and  
24 RUCO's concerns regarding "certain invoices" and notes that once these invoices were

1 brought to its attention, they were removed. Company Brief at 15. These invoices, according  
2 to the Company, should not "taint the entire pool. A few bad apples don't spoil the whole  
3 bushel." Id.

4 The Company's Cost Pool has been on a merry-go-round ride since it filed this case. It  
5 started at \$3,950,700, moved to \$5,269,882, moved again to \$4,815,000, moved again to  
6 \$4,731,412 and has come full circle to \$3,970,000 converted to US dollars. RUCO Brief at 9.  
7 But from the Company's perspective the Commission should not be swayed by a "few bad  
8 apples."

9 Now, the Commission is to believe that the Cost Pool number, arrived at post hearing,  
10 of \$3,950,700 is an accurate representation of the Company's Cost Pool. It seems that the  
11 Company is suggesting that it is accurate because Staff and RUCO pointed out a few  
12 otherwise patently obvious improper invoices during the course of this hearing. The time for  
13 discovery has long passed and the Company has now submitted in its final schedules for final  
14 approval a 20 page list with hundreds and hundreds of entries of items included in the Central  
15 Office Pool. Company's Final Schedules, Exhibit 3. It is unfair and unreasonable at this time  
16 to suggest that Staff and RUCO should go through the exhibit, distinguish these entries from  
17 the entries in prior schedules and ascertain which entries are now appropriate and which are  
18 not.

19 From the beginning, this issue has been more than just about a "few bad apples." It has  
20 been about a bushel of "bad apples" and a significant amount of expense. The fact that the  
21 Company still sees it as simply just about a few bad apples suggests loudly that the Company  
22 remains predisposed to include unnecessary costs. The Commission should reject the  
23 Company's recommended cost allocation calculation.

1 The Company is critical of Staff because of Staff's failure to abide by the National  
2 Association of Regulatory Utility Commissioners ("NARUC") Guidelines for Cost Allocations.  
3 Company Brief at 17. The Company claims both Staff and RUCO's denial of the majority of  
4 the Cost Pool was arbitrary. Id at 16-17. The Company relies on the NARUC Guideline that  
5 requires Staff's auditors to determine what information is relevant for a "particular audit  
6 objective." Id. at 17. The Company suggests that the burden is on Staff, not the Company to  
7 determine which costs should be included in the Cost Pool. Hence, the Company concludes  
8 that Staff's denial of 99 percent of the proposed costs was arbitrary.

9 It is noteworthy that from the Company's perspective, accounting principles and  
10 guidelines should apply when it fits the Company's interests but should be dismissed when  
11 they go against the Company's recommendation such as in the case of the ADIT discussion  
12 above. Nonetheless, the NARUC guideline does not shift the burden to Staff. Staff is not the  
13 entity requesting a rate increase – it is the Company. The Company has the burden of  
14 showing which costs legitimately belong in the Cost Pool. The Company also has a duty to act  
15 in good faith and present only those costs which are appropriate. The Company cannot just  
16 lightheartedly approve hundreds and perhaps thousands of entries then claim the burden shifts  
17 to Staff to go through those entries and determine which ones should be taken out. The  
18 Company knows that "Skye Body Wash" from the "Valentine's Beauty Boutique" is not an  
19 appropriate expense for Rio Rico ratepayers to pay and it should not be RUCO or Staff's  
20 burden to point that out to the Company and/or the Commission. The Company's cost  
21 allocation recommendation is flawed and should be dismissed.

22 The Company claims that it is willing to provide an independent attestation of the Cost  
23 Pool. Well that is nice now that the hearing is over and the matter is being briefed. However,  
24

1 nowhere has the Company agreed to waive the time clock – because that is the only way the  
2 Company's offer would have any meaning.

3 With regard to RUCO's witness, Timothy Coley, the Company claims Mr. Coley  
4 "...simply is not a credible witness on the cost allocation issues." Company Brief at 23. The  
5 Company does not seem to hold Staff's witness on the issue, Gerald Becker, in much higher  
6 regard as the Company claims that the testimony of both Mr. Coley and Mr. Becker do "...  
7 nothing more than state their beliefs or generic opinions that the APT costs do not benefit  
8 ratepayers." Company Brief at 23. The Company further claims that neither Staff nor RUCO  
9 met the evidentiary burden of substantial evidence to support their disallowances. Id. at 23 -  
10 24.

11 First, the evidentiary threshold of substantial evidence is the evidence in the record, not  
12 just the pre-filed testimony of a witness. The discussion of the corporate allocation costs and  
13 the specific expenses was the subject of a great percentage of the hearing. See for example  
14 Transcript at 202 – 363.

15 Second, Mr. Coley explains his recommendation in his direct testimony on this subject  
16 in great detail:

17 Q. What is RUCO's rationale for making the adjustments to the Corporate  
18 Expense Allocation?

19 A. First, RUCO believes that most of the expenses being allocated to the  
20 Arizona Utility Infrastructure regulated affiliates, including RRUI, are  
21 unnecessary and not directly attributable in the provisioning of water  
22 and wastewater services. Second, the unregulated parent Company,  
23 Algonquin Power Income Fund ("APIF" or "Fund"), allocated the costs  
24 down to Algonquin Power Trust ("APT"), which the Company claims is  
another unregulated affiliate. RUCO reviewed the Fund's  
organizational chart of all its affiliates and could not ascertain if APT is  
even an affiliate because APT is not on the organizational chart. Third,  
the Fund allocated costs down to APT, which are later allocated to  
RRUI that included Super Bowl tickets, hockey tickets, basketball  
tickets, gold watches etc. and other licenses, fees, and permits that,

1 should be totally disallowed for ratemaking purposes. Fourth, RUCO  
2 does not agree with the allocation factors utilized by APIF. Finally,  
3 RUCO has concerns with the allocation and documentation methods  
4 between an unregulated parent, the Fund, and regulated affiliates such  
5 as RRUI. The NARUC Guidelines for Cost Allocations and Affiliate  
6 Transactions, attached as RUCO Exhibit 6, states that, "The prevailing  
7 premise of these Guidelines is that allocation methods should not result  
8 in subsidization of non-regulated services or products by regulated  
9 entities..." The Guidelines also suggest that "to the maximum extent  
10 practicable, in consideration of administrative costs, costs should be  
11 collected and classified on a direct basis for each asset, service or  
12 product provided.

.....

8 Q. What is RUCO's position regarding the allocated APT costs of \$1,066,089  
9 to be shared (based on customer count) among the seventeen utility  
10 companies that the Fund owns?

10 A. For all the reasons previously stated by RUCO, only a very small portion  
11 of the \$1,066,089 is attributable to RRUI. RUCO cannot directly trace  
12 any of those costs to RRUI. The invoices essentially contain no detail.  
13 At the very most, only a fraction of the costs would appear to be  
14 attributable to a relatively small sewer company of roughly 2,100  
15 customers such as RRUI.

13 Q. What APT expenses does RUCO believe could be attributable to RRUI?

14 A. RUCO's analysis and review determined that the audit, tax services, legal  
15 – general, and depreciation expenses could possibly benefit the  
16 ratepayers of RRUI to some minor extent.

16 Q. What amount of those expenses does RUCO believe could possibly  
17 benefit RRUI in the provision of utility service?

18 A. RUCO recommends the Commission allow no more than 25 percent of the  
19 APT audit, tax services, legal – general, and depreciation expenses and  
20 disallow 100 percent of the other APT expense as being much more  
21 attributable to the Fund's operating activities.

.....

21 Q. Does RUCO believe RRUI would incur the APT type of expenses if it were  
22 a stand-alone utility and not multi-layered with corporate allocations by  
23 the non-regulated parent and affiliates?

23 A. RUCO believes that RRUI would incur some of the types of expenses  
24 (e.g., audit, tax services, and legal-general expenses) that APT was  
allocating down to its affiliates but certainly not the majority of the type

1 of expenses being allocated by APT. RUCO will provide further  
2 analysis in surrebuttal testimony comparing stand-alone companies to  
companies structured as RRUI.

3 RUCO-9 at 45 – 46, 48-50.

4 Mr. Coley's analysis is by no means exhaustive, nor does it have to be. Substantial  
5 evidence exists unless the administrative decision "is without any evidence to support it, or is  
6 absolutely contrary to uncontradicted and unconflicting evidence upon which it purports to  
7 rest." Richard E. Lambert, Ltd. v. City of Tucson Dept. of Procurement, 223 Ariz. 184, ¶ 10,  
8 221 P.3d at 378, quoting Ariz. Dep't of Pub. Safety v. Dowd, 117 Ariz. 423, 426, 573 P.2d 497,  
9 500 (App.1977). While the Company may not agree with either RUCO or Staff's position, the  
10 Company cannot legitimately claim that there is no evidence to support RUCO and Staff's  
11 position, or that the Company's evidence is uncontradicted.

12 As previously discussed there are hundreds of expenses in the pool and most of the  
13 invoices RUCO received from the Company in support of the proposed expenses contained  
14 very little, if any, detail. Id. RUCO presented an exhibit at hearing that illustrated this point.  
15 RUCO-5 was a data request for supporting documentation for the allocation pool expenses. In  
16 the Company's responses, there was little, if any, explanation in the invoices present of what  
17 the expense was for. At least with regard to the invoices presented at the hearing, the  
18 Company ended up taking most of those invoices out of the allocation pool. Transcript at 259-  
19 284. If the Company chooses to provide little or no detail when asked to support its proposed  
20 cost allocation pool, the burden does not shift to RUCO and/or Staff to oppose the Company's  
21 proposed cost allocation pool – it is the Company that has the burden to support its case. The  
22 Company can quote all the law and precedent it wants on legal standards, but it does not  
23 change the fact that the Company, not Staff and RUCO, has the burden of supporting the  
24 expenses for which the Company seeks recovery.



1       **Revenue Annualization**

2       RUCO incorporates its position set forth in its Closing Brief<sup>1</sup>. RUCO Brief at 10-11.

3       **Rate Case Expense**

4       RUCO incorporates its position set forth in its Closing Brief. RUCO Brief at 11-12.

5  
6       **III. COST OF CAPITAL**

7       Like the Gold Canyon case before, and any case where a utility proposes an imprudent  
8       capital structure of 100 percent equity, the cost of capital issue comes down to the best  
9       method to adjust for the Company's financial risk. The Company has an actual capital  
10       structure of 100 percent equity. The Company's actual capital structure is out of line with the  
11       industry average and deprives ratepayers of the benefits associated with debt and is therefore  
12       imprudent. RUCO's Brief at 12. RUCO believes that a hypothetical capital structure is more  
13       appropriate here because it best balances the interests of the ratepayers and the  
14       shareholders. Id. at 13. Staff believes that a 100 percent equity capital structure "unnecessarily  
15       burdens" the ratepayers and has applied a Hamada adjustment to its recommended cost of  
16       equity to adjust for risk. Transcript at 1093. While there is evidence in the record to support  
17       either approach, the better approach here is the application of a hypothetical capital structure.

18       The Company's approach to adjust for risk, on the other hand, was to make both  
19       upward and downward adjustments for the absence of risk in its cost of equity  
20       recommendation. Company Brief at 39. However, the Company's 11.7 percent cost of equity  
21       is so far out of line with what would be a reasonable and appropriate cost of equity in this case,  
22       it should simply be dismissed. The Company's recommendation should not come as a

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23       <sup>1</sup> Where RUCO's Closing Brief replies to the arguments raised in the Company's Closing Brief and RUCO has  
24       nothing more to add or where the Company has not addressed an issue in its Closing Brief, RUCO will simply  
      incorporate the argument that it made in its Closing Brief as its reply.

1 surprise given the Company is actually proposing upward adjustments for risk when it has a  
2 100 percent equity structure. The Company does not seem to get the point that the economy  
3 has been on the decline and only recently has shown progress. The Company hangs on to its  
4 misguided belief that Arizona has a risky regulatory environment. Company Brief at 39.  
5 Interestingly, despite the regulatory risk the Company complains of, the Company's parent still  
6 managed to invest in numerous regulated water and wastewater utilities in Arizona.  
7 Apparently, the Company's parent has a different perspective than the Company on the risk of  
8 doing business in Arizona's regulatory environment.

9 The Company claims that RUCO's cost of equity recommendation is 6.9 percent.  
10 Company Brief at 42. This is not true - RUCO is recommending a 9.00 percent cost of equity.  
11 RUCO-18 at 3. The Company's statement is not only misplaced but it is a misrepresentation  
12 of RUCO's position.

13 RUCO's hypothetical capital structure will produce an appropriate level of income tax  
14 expense for ratemaking purposes. Since the Company does not have debt, there is no interest  
15 deduction to offset the Company's income tax expense. RUCO Brief at 12. Hence, ratepayers  
16 are being asked by the Company to pay more income tax expense than they should because  
17 of the Company's choice to use an imprudent capital structure. The level of income tax that  
18 results from the hypothetical capital structure is the appropriate level of income tax. The  
19 Company completely ignores this aspect, believes that ratepayers should pay its intentionally  
20 overinflated income tax expense, and wants the Commission to believe that this method to  
21 adjust an overinflated amount of income tax expense is nothing more than a 210 point  
22 reduction to RUCO's return on equity recommendation. The issue of interest synchronization  
23 has nothing to do with RUCO's recommended return on equity. This is a red herring argument  
24 and the Company has misrepresented RUCO's return on equity recommendation.

1 RUCO does not agree with Staff's 60 point downward adjustment using the Hamada  
2 formula. But RUCO recognizes that it would be a misrepresentation to argue that Staff's  
3 recommended return on equity is 9.80 percent and not 9.20 percent (9.80 percent - 60 point  
4 Hamada adjustment = 9.20). The Company should not take its disagreement with RUCO's  
5 position and use it to misrepresent RUCO's recommendation. RUCO is recommending a 9.00  
6 percent cost of equity which is fair and reasonable under the facts and circumstances of this  
7 case.

8 The Company is critical of RUCO's cost of capital analysis for other reasons as well.  
9 First, the Company contends that RUCO erred in using a proxy of gas utilities to derive its cost  
10 of capital because the average beta for RUCO's water utility sample is .83, compared with its  
11 natural gas sample of .67. Company Brief at 57. The Company used a water proxy of six  
12 water utilities to complete its cost of capital analysis. Id. at 55. The Company's proxy included  
13 Aqua America, which has a beta of .65. S-13, Schedule JCM-7. The Company cannot  
14 complain that RUCO used gas utilities with average beta of .67 when one sixth of the  
15 companies in its water proxy have a lower beta of .65.

16 The Company contends that gas companies are less risky investments than water  
17 companies as evidenced by their low beta and therefore, should not be used as proxies for the  
18 Company. Company Brief at 57. Mr. Rigsby testified that in the current economy utilities are  
19 viewed as a safe haven for investors and that both water and gas utilities share that perception  
20 of being recession proof. RUCO-18 at 7. There are multiple measures of risk. Beta is one,  
21 and Value Line safety and financial strength as well as Standard and Poor's stock ranking are  
22 also alternatives.

1       The Company's reliance on water proxies alone also ignores the clear guidance of the  
2 courts<sup>2</sup>. To determine an appropriate cost of equity capital, the Commission needs to consider  
3 all relevant factors, including: (1) comparisons with other companies having corresponding  
4 risks, (2) the attraction of capital, (3) current financial and economic conditions, (4) the cost of  
5 capital, (5) the risks of the enterprise, (6) the financial policy and capital structure of the utility,  
6 (7) the competence of management, and (8) the company's financial history.<sup>3</sup> Mr. Rigsby  
7 testified that he used gas utilities as a proxy because they have similar operating  
8 characteristics to water companies in terms of distribution and similar risks. Transcript at  
9 1007. Based on the foregoing, RUCO did not err in deriving its cost of equity capital using a  
10 gas proxy.

11       Next, the Company claims RUCO's use of a geometric mean and current risk premium  
12 in its CAPM analysis was improper. Company Brief at 59-63. In calculating a cost of equity,  
13 both the Company and RUCO used the Capital Asset Pricing Model ("CAPM"). The CAPM is  
14 a mathematical tool developed during the early 1960's by William F. Sharpe, the Timken  
15 professor Emeritus of Finance at Stanford University. RUCO-17 at 30. CAPM is used to  
16 analyze the relationships between rates of return on various assets and the risk as measured  
17 by beta. Id. The underlying theory behind the CAPM states that the expected return on a given  
18 investment is the sum of a risk-free rate of return plus a market risk premium that is  
19 proportional to the systematic, non-diversifiable risk associated with that investment. Id. at 30-  
20 31.

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22  
23 <sup>2</sup> United Railways & Electric Company of Baltimore v. West, 280 U.S. 234, 249-50, 251, 50 S.Ct. 123, 125,  
125-26, 74 L.Ed. 390 (1930); Simms v. Round Valley Light & Power Company, 80 Ariz. 145, 154, 294 P. 378, 384  
(1956).

24 <sup>3</sup> Litchfield Park Service Corporation v. Arizona Corporation Commission, 178 Ariz. 431, 435, 874 P.2d 988,  
992 (Ariz. App. Div. 1 1994).

1 The Company arrived at its CAPM cost of equity capital of 13.0 percent by taking the  
2 midpoint of low end of its CAPM range -10.3 percent and the high end of the range – 15.6  
3 percent. A-7 at 2. RUCO derived its CAPM cost of equity capital based on an historic market  
4 risk premium. RUCO-17 at 34. RUCO calculated a range for its CAPM cost of equity capital  
5 between 5.72 percent (7.29 percent for its water sample) and 5.05 percent (6.32 percent for its  
6 natural gas proxy). Id. at 36.

7 The Company claims that RUCO's CAPM analysis is not reliable because it is based on  
8 an historic market risk premium. Company Brief at 60. RUCO submits that reliance on past  
9 performance as an indicator of future performance is sounder than reliance on analysts'  
10 projections of market return and treasury yields. RUCO-18 at 15.

11 The Company also claims that RUCO's historic market risk premium is also unreliable  
12 because it is based in part on a geometric mean. Company Brief at 59. The Company claims  
13 that RUCO's historic market risk premium should be based upon an arithmetic mean. RUCO's  
14 historic market premium was derived from both a geometric and an arithmetic mean of the  
15 historical returns on the Standard and Poor 500 ("S&P 500") index from 1926 to 2008 as the  
16 proxy for the market rate of return. RUCO-17 at 34. For the risk-free portion of the risk  
17 premium component, RUCO used the geometric mean of the yields of long-term government  
18 bonds for the same eighty-two year period resulting in an historic risk premium of 4.20 percent  
19 using a geometric mean and a historic risk premium of 6.10 percent using an arithmetic mean.  
20 Id.

21 The use of geometric mean is the industry standard. From the utilities standpoint,  
22 however, the use of the geometric mean is not preferable. In situations where variability  
23 exists, a geometric mean will always be lower than an arithmetic mean. RUCO-18 at 11.  
24 Perhaps, this explains why the utilities so strenuously object to the use of the geometric mean.

1 The Commission however, has used authorized rates that were derived through the use  
2 of both arithmetic and geometric means. In the matter of UNS Gas, the Commission  
3 concluded:

4 *We agree with the Staff and RUCO witnesses that it is appropriate to*  
5 *consider the geometric returns in calculating a comparable company*  
6 *CAPM because to do otherwise would fail to give recognition to the fact*  
*that many investors have access to such information for purposes of*  
*making investment decisions.*

7 Decision No. 70011 at 14.

8 Recent empirical research also supports RUCO's market risk premium. RUCO-18 at  
9 12. Mr. Rigsby testified that empirical studies performed by Aswarth Damdaran and Felicia C.  
10 Marston, professors of finance from New York University and the University of Virginia,  
11 respectively, indicate that market risk premiums in excess of 4.5 to 5.5 percent are overstated.  
12 Id. at 15-16.

13 Mr. Bourassa's range of risk premiums used an average historical market risk premium  
14 of 6.5 percent and an average current market risk premium of 17.74 percent. A-5 at 34.  
15 RUCO's historic risk premium using both an arithmetic and geometric means ranges between  
16 4.20 percent and 6.10 percent. RUCO-17 at 34. The average of Mr. Rigsby's geometric and  
17 arithmetic mean, 5.10 percent, falls in the range identified as reasonable by recent empirical  
18 research. Mr. Bourassa's range of risk premium does not. The Commission should reject the  
19 Company's cost of equity capital recommendation.

20 In the end, the Company, RUCO and Staff can disagree on the methodologies but what  
21 is important is to arrive at a fair cost of capital recommendation. For a long time the  
22 Commission has been approving cost of equities for water and/or wastewater utilities at or  
23 slightly below 10 percent. More recently, in the UNS Gas case, the Commission recognized  
24

1 the current economy and its effect on a utility's return on equity and approved a 9.5 percent  
2 return on equity for UNS Gas. Decision No. 71623 at 42. What the Commission said in UNS  
3 Gas is particularly applicable here:  
4

5 In his testimony, Mr. Parcell raises valid arguments with  
6 respect to the effect of current economic conditions on all aspects  
7 of the economy, and on society in general. Although Mr. Parcell  
8 recommended adoption of the 10.0 percent midpoint in his cost of  
9 equity range, he testified that it is "appropriate for the Commission  
10 should they choose to do so, to go to the low end of the range to  
11 reflect economic conditions," and that setting the ROE at 9.5  
12 percent "would be proper and supportable." (Tr. 844.)

13 We do not believe UNS Gas has demonstrated that its risk is  
14 significantly greater compared to other comparable companies; nor  
15 has it shown that its risks have increased substantially since its last  
16 rate case. The Company cannot pretend that it operates in a  
17 vacuum or that the challenges it faces are unique. Indeed, relative  
18 to a number of unregulated industries, the utility industry is  
19 insulated from the vagaries of the marketplace to the extent that it  
20 does not face direct competition for its product and there is a high  
21 degree of inelasticity in the need for utility services.

22 We believe that adoption of an estimated ROE of 9.50 percent  
23 will allow the Company to attract capital at a reasonable rate, and  
24 strikes a reasonable balance between its proposal for an estimated  
ROE near the top of the range produced by its own analysis and  
the results achieved through the methodologies employed by Staff  
and RUCO. We also believe that adoption of an estimated cost of  
equity at the low point of Staffs ROE range, 9.50 percent, provides  
at least some minimal recognition of the devastating effects of  
current economic conditions on UNS Gas's customers, as  
established in the record of this case.

19 Decision 71623 at 42. Decision No. 71623 was docketed on April 14, 2010. Not much has  
20 changed regarding the economy in the last month and there should be "... recognition of the  
21 devastating effects of current economic conditions on..." Rio Rico's customers. RUCO's return  
22 on equity recommendation reflects the current economic conditions and is fair to both the  
23 ratepayers and the shareholders.  
24

1 **IV. RATE DESIGN**

2 RUCO incorporates its position set forth in its Closing Brief. RUCO Brief at 18.

3 **V. HOOK-UP FEE TARRIFF ("HUF")**

4 The Company claims RUCO opposes its "traditional means" of financing its off-site  
5 plant. Company Brief at 74. The Company is referring to the use of HUF as the means of  
6 financing. The Company has once again misunderstood RUCO's position. RUCO does not  
7 oppose the use of HUF as a form of financing. RUCO opposes the language in the  
8 Company's proposed tariffs which does not require the Company to record its contributions as  
9 CIAC until such time as the amounts are expended for plant.

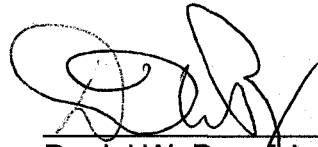
10 The Company claims that RUCO paid no attention to its interpretation of the NARUC  
11 definition of CIAC. Company Brief at 75. However, the NARUC definition does not distinguish  
12 CIAC that is treated as a reduction to rate base from CIAC that is not treated as a reduction  
13 from rate base. Yet, the Company wants to do just that – it distinguishes CIAC that is a  
14 deduction from rate base with the unexpended CIAC which it does not want to treat as a  
15 deduction. There is no Commission rule, definition or case for that matter that makes such a  
16 distinction. In fact, in RUCO's Closing Brief, RUCO references Decision Nos. 71414 and  
17 71410 where the Commission rejected similar requests by utilities to exclude unexpended  
18 CIAC as a deduction from rate base. RUCO Brief at 19. The Company's argument lacks merit  
19 and should be rejected again.

20  
21 **CONCLUSION**

22 For the reasons discussed above, RUCO recommends the Commission adopt its  
23 position in this case, and reject the positions of Staff and the Company, to the extent they  
24 conflict with RUCO's recommendations.



1 RESPECTFULLY SUBMITTED this 10<sup>th</sup> day of May, 2010.

2  
3  
4   
Daniel W. Pozersky  
Chief Counsel

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6 of the foregoing filed this 10<sup>th</sup> day  
7 of May, 2010 with:

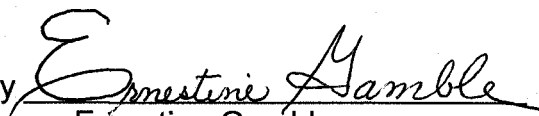
8 Docket Control  
9 Arizona Corporation Commission  
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Phoenix, Arizona 85007

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